NAIC International Insurance Forum

Global Insurance Solutions

As of May 2018

ON MAY 14–15, WE ATTENDED THE 2018 NAIC INTERNATIONAL INSURANCE FORUM IN WASHINGTON, D.C. TO STAY INFORMED ON IMPORTANT REGULATORY ISSUES THAT ARE AFFECTING THE INSURANCE INDUSTRY TODAY. SUMMARIZED IN THIS DOCUMENT ARE THE MOST RELEVANT DISCUSSIONS FROM THE MEETING.

KEY SESSIONS AND TOPICS (Full details below)

- **The role of insurance in disaster risk management**
  - As natural disasters become an ever-increasing global reality, insurers and regulators must help to educate consumers of proper risk mitigation and potential protection gaps.
- **C-suite perspective: Insurance in the 21st century**
  - Insurers will continue to focus on innovation and technology as they realize the significant influence of the tech industry on their operations.
- **Systemic risk regulation**
  - Insurers are supportive of an activity-based approach to regulation vs. an entity-based approach which tends to focus on company size, while regulators strive for improved coordination among jurisdictions.
- **Update on ETFs and the use of Systematic Valuation**
  - As insurers consider the role and treatment of ETFs in their portfolios, time will tell if the Systematic Value approach becomes a more prevalent valuation methodology.

THE ROLE OF INSURANCE IN DISASTER RISK MANAGEMENT

Natural disasters have increasingly become a fact of life in many regions across the globe. Managing risk has become a balancing act between mitigation activities and raising awareness of the benefits insurance can offer those in natural disaster-prone areas. From torrential rains and earthquakes in Japan to hurricanes in the Caribbean, regardless of geographical location there are common tools that are vital when thinking about effective risk management.

Just as important as it is to be insured, mitigation activities play a large part in helping communities withstand the effects of natural disasters. Investments by insurers and local communities into public awareness programs can go a long way in helping to reduce loss of life, personal injuries and property damage.

GLOBAL INSURANCE SOLUTIONS

J.P. Morgan's **Global Insurance Solutions Group** is dedicated to delivering customized and integrated solutions to insurers globally.

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Asset Management

There can be significant periods of time—years or even decades—between natural disasters, often causing consumers to become complacent and underestimate their risk. Insurers and regulators must help to educate the communities they serve. When losses are assessed in the wake of disasters, there are often huge protection gaps between insured losses and total losses. This is largely due to the effects of underinsurance—consumers are often not properly educated on the coverages necessary to adequately address their risks. For example, the distinction between market value and replacement value can cost a homeowner thousands of dollars in uninsured losses. Additionally, most U.S. homeowners mistakenly believe their policies protect against floods, only to realize their protection gap once disaster strikes.

Climate science is also helping efforts to better understand the potential risk and impacts of disasters. Weather patterns are changing and insurers must adjust accordingly. This includes catastrophe loss modeling and pricing—as the data used in these models becomes more granular and refined, it will allow insurers to more precisely and accurately estimate risk at a detailed topographical level, which in turn can have a positive impact on consumer pricing, coverage levels and overall insurance availability.

C-SUITE PERSPECTIVE: INSURANCE IN THE 21ST CENTURY

Chief executives of Lloyd's of London, John Hancock and Ameritas shared their takes on major issues confronting multinational insurers. A major focus for 2018 and beyond will be on innovation and technology. Insurers are quickly realizing that the tech industry's influence is having a sizable impact on the way they operate. Insurers have begun to digitalize significant parts of their businesses, including a movement away from physical dependency on paper in the underwriting process and increased cybersecurity measures. Cyber risk knows no geographical boundaries, so the industry will have to work together to protect consumers' personal data. Insurers will also need to be open-minded in how they engage and interact with their customers in today's age. Millennials, generally, are much more accustomed to direct-to-consumer and online product engagement; selling insurance products through traditional agent networks may not be as effective when compared to sales efforts of days past. Social media is also essential, especially as insurers strive to help younger generations understand the importance and value of coverage.

On the regulatory front, the effects of tax reform and IFRS 17 were of concern to the panel. The shared sentiment is that tax reform in the U.S. is an overall positive for the industry, with the biggest concerns being the impact on product pricing (long-term), tax reserves and *risk based capital*. Regarding *IFRS 17*, there is sentiment in Europe that some would wish to delay the 2021 effective date, concerned with the potential cost of implementation and the future profitability and viability of certain product lines. In January of this year, Aptitude Solutions, a financial software company, released an assessment report that surveyed 240 insurers on their IFRS 17 readiness: 92% of respondents had yet to put their IFRS 17 solutions in place, which stressed widespread doubts as to whether insurers will be ready to convert and comply with IFRS 17 when 2021 arrives.

SYSTEMIC RISK REGULATION

A mixed panel of regulators and insurance executives debated the benefits and perils of systemic risk regulation for large, internationally active insurers. With regulators moving toward an activities-based approach to systemic risk regulation and away from evaluating systemic risk through an entity-based lens, panelists discussed the role of macroprudential tools in enhancing insurer supervision.

The global financial crisis showed regulators the deficiencies of past supervisory practices that relied on microprudential and individual firm-level policies. In response to those deficiencies, the International Association of Insurance Supervisors (IAIS) developed a framework for implementing macroprudential policies and surveillance (MPS) in the insurance sector. MPS focuses on the system-wide impact of shocks that could cause significant disruption to the global financial system and economic activity, while the Financial Stability Board's (FSB) global systemically important financial institutions (G-SIFI) policy framework aims to reduce the impact of failure of individual firms. The insurers represented on the panel, which included Prudential Financial and New York Life, were supportive of an activity-based approach to regulation, noting that an entity-based approach tended to focus on a company's size, as opposed to the type of activities in which it engages. Sheer size doesn't inherently make a firm riskier—other factors such as business model, capital level and liquidity are also at play. The insurance panelists also expressed interest in having more influence on policy initiatives. Insurers find it difficult to operate under constant regulatory change, and their increased input could help to provide regulatory stability and build trust between insurers and regulators.

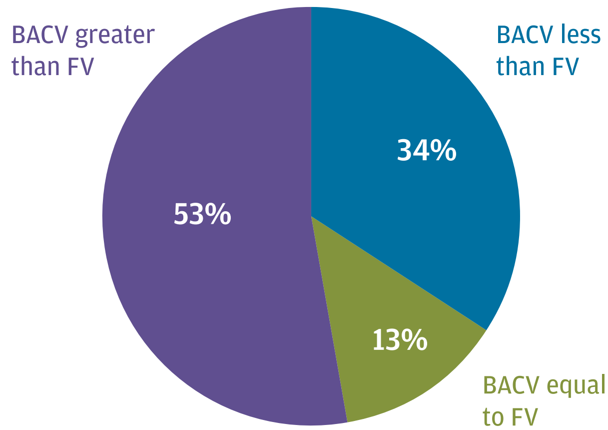
From the regulators' perspective, improved coordination of regulatory objectives among jurisdictions will help provide clearer direction for insurers. Panelists recognized that, for U.S.-based insurers, the Federal Reserve must do a better job of partnering with the NAIC in order to be fully effective in its efforts to strengthen the financial system. Regulators must also show an appreciation for differing business models when designing controls and reconciling the impact of several accounting regimes. The costs to comply with competing accounting rules can be burdensome, with insurers questioning the benefit to their operations and whether it ultimately makes them safer. In all, the NAIC recognizes the important role it plays in global regulation as it has begun to modify its own group supervisory framework and become increasingly involved in the evolution of an international group supervisory framework.

UPDATE ON ETFs AND THE USE OF SYSTEMATIC VALUATION

Back in 2017, the NAIC adopted *new valuation rules* regarding an alternative amortized cost valuation methodology for bond exchange traded funds (ETFs), known as Systematic Value (SV). The rules required that all NAIC Securities Valuation Office (SVO)-identified bond ETFs currently held by U.S-regulated insurance entities be designated as either fair value or systematic value at year-end to determine how these investments would be carried on their individual balance sheets. Based on 2017 year-end filing information, the NAIC identified 150 bond ETFs designated for SV, illustrating insurers' intent to utilize a valuation method that helps mitigate the effects of market volatility. One third of these ETFs were reported with a carrying value less than fair value, while the majority of SV-designated ETFs had carrying values either equal to or greater than FV (**Exhibit 1A**). Additionally, approximately 91% of the SV-designated ETFs were rated as investment grade, with NAIC ratings coming in at either NAIC 1 or NAIC 2 (**Exhibit 1B**). As insurers look to consider the usage of ETFs in their portfolios, it will be interesting to see if the use of SV as a valuation technique becomes more prevalent in the industry.

150 Bond ETFs were designated for Systematic Value

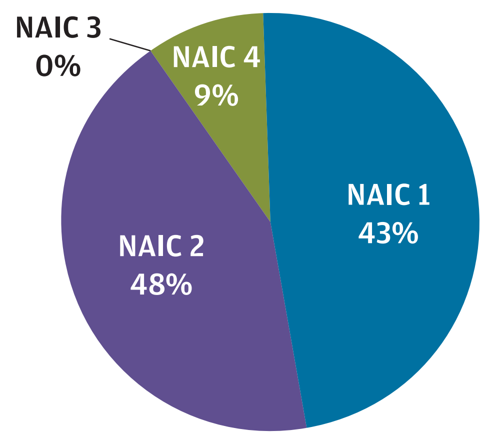
EXHIBIT 1A: BALANCE SHEET IMPACT OF ETFs CARRIED AT SV WHEN COMPARED WITH THEIR RESPECTIVE FV



Source: NAIC.

BACV = Book-Adjusted Carrying Value; FV = Fair Value; SV = Systematic Value

EXHIBIT 1B: RISK PROFILE FOR ETFs DESIGNATED FOR SV



Source: NAIC.

SV = Systematic Value

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